

Maximizing DOD's Untapped Potential to Improve Business Performance

DOD Performance Breakthrough Convention
Lansdowne, VA
October 14, 2009

Gene L. Dodaro,
Acting Comptroller General of the United States

It is a pleasure to be here today to discuss business operations at the Department of Defense (DOD). The Deputy Secretary and other conference organizers are to be commended for bringing together senior leaders from inside and outside DOD. Collaboration and partnering are central enablers. We have worked hard to incorporate these principles into daily practice at GAO.

I recognize that business practices at DOD are not going to change overnight. But this conference can help this process by encouraging an exchange of ideas. By sharing professional experiences and expertise, everyone here has an opportunity to enrich DOD's knowledge base and help build the Department's capacity to develop new solutions to old problems. Your presence here today is evidence of the defense workforce's strong work ethic and commitment to its mission. These basic DOD values, combined with strong leadership and follow-through, can achieve huge improvement in business practices because there is a lot of untapped potential at DOD to get better results and the best support to the warfighter.

As I looked over the conference materials, the goals set forth for DOD are laudable. Those goals are to

- demonstrate support for the President's directive to improve business operations;
- showcase success stories about enterprise-wide performance improvement; and
- establish an ongoing review process to solve enterprise-wide challenges.

These goals recognize the shared opportunities and responsibilities to address longstanding weaknesses in DOD business operations and achieve measurable and sustainable results. Identifying the challenges is the easy part, as those of you who navigate DOD's business processes on a daily basis know all too well. The hard part is identifying solutions, taking action, sustaining progress, and maintaining momentum.

As is the case for other federal agencies, the Nation's fiscal situation has significant implications for DOD. Specifically, the Department faces competing demands for resources and a number of internal fiscal pressures as it tries to support ongoing operations, rebuild readiness, and prepare for the future. While these circumstances are challenging, they also underscore the need for constructive change.

Report Documentation Page				Form Approved OMB No. 0704-0188	
Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.					
1. REPORT DATE 14 OCT 2009		2. REPORT TYPE		3. DATES COVERED 00-00-2009 to 00-00-2009	
4. TITLE AND SUBTITLE Maximizing DOD's Untapped Potential to Improve Business Performance				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) U.S. Government Accountability Office, 441 G Street NW, Washington, DC, 20548				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT Same as Report (SAR)	18. NUMBER OF PAGES 20	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

This afternoon, I will discuss how DOD can leverage this opportunity to encourage business transformation. My intent is to stimulate your thinking and encourage decisive actions to help DOD operate more efficiently and effectively. I expect that the presentations you will hear over the next few days will describe projects that have already improved business performance. My hope is that those presentations may also be an impetus for future change.

Fiscal Challenges Facing the Nation and DOD

No one and no organization is immune from America's fiscal challenges. That includes DOD. Given the reality of growing federal budgetary constraints, it is essential that DOD become more efficient and put its resources to better use.

It is important to have a perspective about our government's fiscal challenges before talking about the fiscal pressures facing DOD. Weaknesses in the economy and financial markets—and the government's response to them—have contributed to an increase in the federal deficit and debt. As shown in the table below, the fiscal year 2009 deficit reached a record \$1.4 trillion and the debt held by the public exceeded 50 percent of GDP.

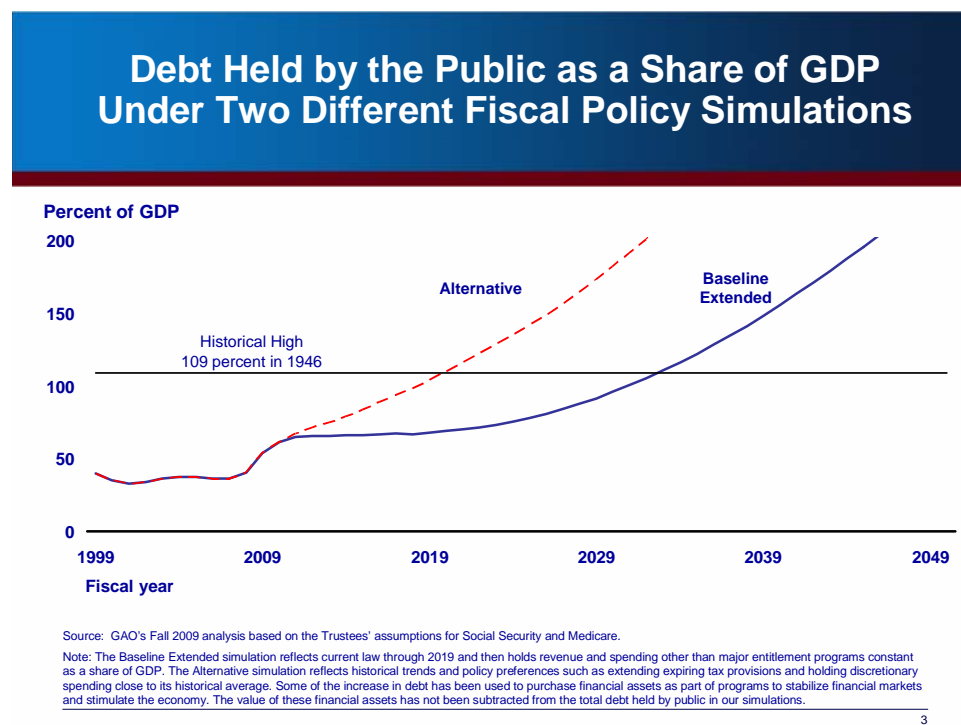
Deficits, Debt Held by the Public and Debt Subject to Limit

	Actual Fiscal Year 2001 (as of 09/30/01)	Actual Fiscal Year 2005 (as of 09/30/05)	Actual Fiscal Year 2008 (as of 09/30/08)	Estimated Fiscal Year 2009 (as of 09/30/09)
Surplus (+)/ Deficit (-) (trillions of dollars)	\$0.1	\$-0.3	\$-0.5	\$-1.4
Surplus (+)/ Deficit (-) (percent of GDP)	1.3%	-2.6%	-3.2%	-9.9%
Debt held by the public (trillions of dollars)	\$3.3	\$4.6	\$5.8	\$7.5
Debt held by the public (percent of GDP)	33.0%	37.5%	40.8%	53.1%
Debt subject to the limit (trillions of dollars)	\$5.7	\$7.9	\$10.0	\$11.9

2

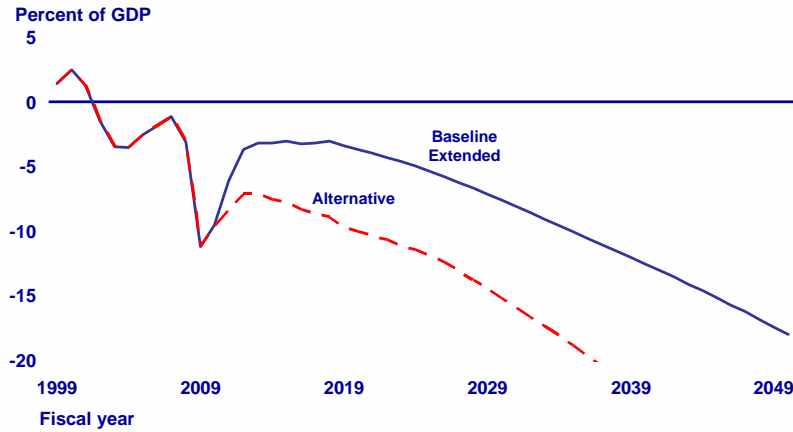
While a lot of attention has been given to the government's current fiscal situation, the government faces even larger financing challenges that will persist long after the economy recovers and the financial markets stabilize. As this graph shows, recent GAO simulations indicate that federal debt held by the public will increase dramatically over the next several

decades and could trend towards 200 percent of GDP. In the Baseline Extended simulation, which reflects current law through 2019 and then holds revenue and spending other than major entitlement programs constant as a share of GDP, discretionary spending is lower as a share of the economy, and revenues are higher than the 20-year historical average. In the Alternative simulation, which reflects historical trends and policy preferences, both discretionary spending and revenue as a share of the economy are nearly at the historical averages. Let me put this into perspective. Under one scenario, in a little over 10 years, debt held by the public as a share of GDP could exceed the historical high reached in the aftermath of World War II.



These debt levels reflect the cumulative effect of growing deficits. While the timing of deficits and the resulting debt buildup varies depending on the assumptions used, both simulations show that the federal government is on an unsustainable path.

Federal Budget Surpluses and Deficits Under Different Fiscal Policy Simulations



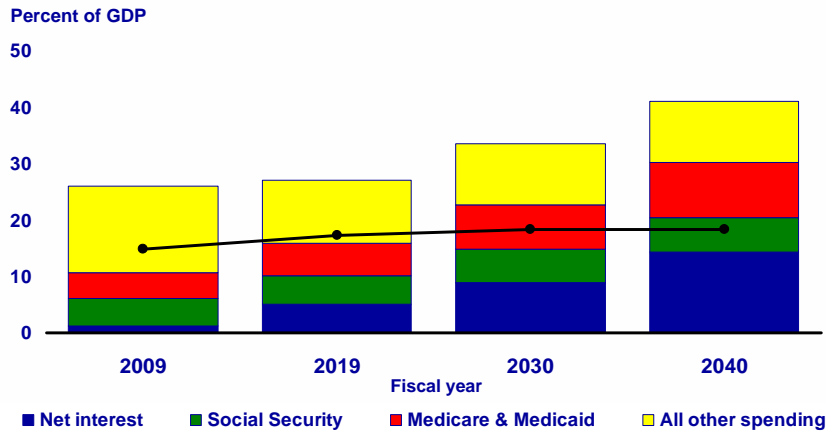
Source: GAO's Fall 2009 analysis based on the Trustees' assumptions for Social Security and Medicare. We also run simulations using CBO's projections for Social Security and Medicare. The results are not materially different.

Note: The Baseline Extended simulation reflects current law through 2019 and then holds revenue and spending other than major entitlement programs constant as a share of GDP. The Alternative simulation reflects historical trends and policy preferences such as extending expiring tax provisions and holding discretionary spending close to its historical average.

4

What drives this outlook? Primarily rising health care costs and an aging population. Assuming no changes in Medicare, Medicaid or Social Security, spending on those programs and interest on the federal debt will account for an ever-growing share of the economy, which will in turn affect the availability of resources for discretionary spending. If revenue remains near the historical average of about 18 percent for the next few decades, which is depicted by the line in the graph below, every federal agency, including DOD, will be subject to tighter budgets as discretionary spending is squeezed.

Potential Fiscal Outcomes Under GAO's Alternative Simulation: Revenues and Composition of Spending

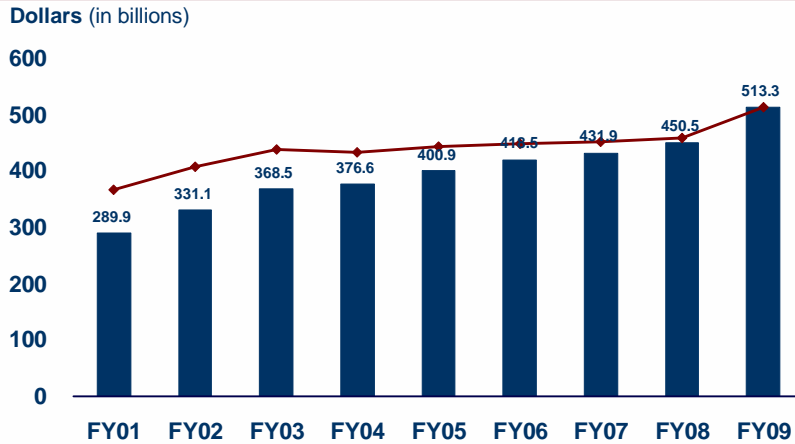


Source: GAO's Fall 2009 analysis based on the Trustees' assumptions for Social Security and Medicare.

5

Clearly, DOD is unique among federal agencies due to its size and budget as well as the complexity of its organizational structure and mission. Not only does its budget represent a little over half of the entire federal government's discretionary spending, the level of resources provided to the Department has increased significantly over time, as the following graph shows. For fiscal year 2009, Congress provided about \$664 billion for DOD, including about \$513 billion for base needs and about \$151 billion for contingency operations. And, since 2001, DOD has received a total of about \$893 billion to support contingency operations, including military operations in Iraq, Afghanistan, and elsewhere around the world.

DOD Budget Authority FY 2001-2009 (Excluding Contingency Operations)



Source: DOD.
Note: bars reflect nominal dollars, line reflects constant FY09 dollars.

6

Notwithstanding the external pressures, DOD faces its own near-term and long-term internal fiscal pressures as it attempts to balance competing demands from within. Let me touch on a few areas we have highlighted for the Congress and the new administration.

--First, ongoing operations will continue to require substantial amounts of resources. The magnitude of costs for operations in both Iraq and Afghanistan will depend on several factors and, in some cases, assumptions and decisions that have not yet been made. For example, costs will be influenced by how the U.S.-Iraq security agreement and associated troop redeployment plans are implemented, the nature and extent of continued U.S. military and civilian presence in Iraq as well as decisions on the size of the force to be deployed to Afghanistan, the types of facilities needed to support troops remaining in and around Iraq, the amount of equipment to be repaired or replaced, as well as health care needs of returning service members. Although drawing down troop levels may on its surface appear to lower costs, GAO has seen from previous operations in the Balkans and Kosovo that costs could rise in the near term because of the cost variables I just mentioned.

--Extended military operations have taken a toll on readiness and rebuilding the force will undoubtedly have a big price tag. Since 9/11, U.S. forces have operated at a high pace and gained considerable combat experience. But this high operational tempo has significantly affected the readiness of the force, especially in the Army and Marine Corps. Personnel are deploying frequently and have little time to train for anything other than counterinsurgency missions. Equipment is used repeatedly, causing wear and tear. Units that are not deployed are transferring equipment and personnel to deploying units, causing some shortfalls. Also, the Air Force and the Navy are facing challenges in maintaining aging aircraft and ships. Rebuilding

readiness is a complex and costly effort, but it will be even more challenging because, at the same time, DOD is pursuing broad-based initiatives to grow, modernize, and transform its forces and capabilities.

--Personnel and health care costs are increasing. DOD's military personnel outlays have risen significantly since fiscal year 2000, fueled in part by increases in basic pay, housing allowances, recruitment and retention bonuses, incentive pays and allowances, and other special pays. In addition, a large portion of DOD's compensation-related costs is in the form of benefits and deferred compensation, and DOD's costs to provide benefits such as health care have continued to spiral upward. Expanded health care to reservists, their families, and retirees has been the primary cost driver in growing benefits costs.

--Cost growth in weapon systems programs remains a significant problem. In fact, total acquisition cost growth on DOD's fiscal year 2008 portfolio of major programs has reached nearly \$300 billion over initial estimates. DOD's ability to successfully adapt to budgetary constraints will depend in great measure on its ability to better manage weapon systems acquisition. This is a long-standing challenge at DOD. Back in 1990, GAO first designated DOD's management of major weapon systems acquisitions as a high-risk area. The bottom line is that programs continue to take longer, cost more, and deliver fewer quantities and capabilities than originally planned. Why does this occur? It's because at the program level, programs are initiated without enough knowledge about system requirements, technology and design maturity. Lacking such knowledge, managers rely on assumptions that are consistently too optimistic, exposing programs to significant and unnecessary risk, and ultimately cost growth and delays. Cost overruns lead to fewer resources for other priorities and reduced buying power for DOD, and schedule delays mean that the warfighter does not get critical capabilities when needed and therefore relies on legacy systems or goes without. While I will touch on this later, I do want to say that recent statements and actions of the President, Congress, and the Secretary of Defense to bring greater attention to acquisition reform are encouraging.

Targets of Opportunities for Reform

Given the rising pressures on the federal budget in both the short and long term as well as the internal fiscal pressures DOD faces, it can no longer afford to conduct business as usual. DOD has a proven track record in maintaining a highly capable warfighting force, but has not achieved the same level of effectiveness on its business side. For more than a decade, DOD has dominated GAO's list of federal programs and operations that we consider to be high-risk and vulnerable to fraud, waste, abuse, and mismanagement. In fact, all the DOD programs on the high-risk list relate to business operations that support the warfighter, including systems and processes related to management of contracts, finances, the supply chain, and support infrastructure, in addition to weapon systems acquisition. Inefficiencies and other longstanding weaknesses in these areas lead to challenges in supporting the warfighter, billions of dollars being wasted annually, and missed opportunities to free up resources for higher priority needs.

Clearly, DOD's size and complexity contribute to the challenges it faces in improving business performance. To the Department's credit, we have seen greater top management emphasis on reform in the past several years as well as measurable progress in some areas. It is obvious that this progress would not have been possible without the significant time and efforts of a highly competent, hardworking and dedicated defense workforce, including those of you who are here today.

While a change in administration requires concerted efforts from all levels to sustain momentum from the past, it also offers new opportunities for change. In this context, we see positive indicators that suggest the environment is conducive for DOD to make great strides. For example:

- President Obama has emphasized, publicly and in directives, that the federal government needs to be more transparent and that contracting reforms are needed across the federal agencies;
- Secretary Gates, in developing DOD's fiscal year 2010 budget submission, initiated decisions to adjust or terminate programs which indicated a willingness to reevaluate programs and make the hard decisions to eliminate or take other corrective action on those that are not performing well;
- In December 2008, DOD revised its acquisition policy in ways that could, if implemented properly, provide a foundation for developing individual acquisition programs with sound, knowledge-based business cases. This revision establishes early milestone reviews, requires completion of key systems engineering activities and competitive prototyping, and emphasizes preliminary design reviews prior to program initiation; and
- Also, the Congress enacted the Weapon System Acquisition Reform Act of 2009 to add further discipline and accountability to the acquisition system. This legislation contains several requirements, including that DOD develop mechanisms to consider trade-offs among cost, schedule, and performance in establishing program requirements and to certify that trade-offs have been made.

DOD can capitalize on this renewed emphasis on achieving greater fiscal discipline, accountability and effectiveness, and take decisive action to produce results in the near-term. Before discussing specific targets of opportunity, let me highlight some key elements that must be present to achieve near-term results.

It will clearly take sustained and focused top-level leadership and sound plans to guide transformation efforts. For the first time, DOD has a Chief Management Office position, established in law as part of the Deputy Secretary of Defense's responsibilities. As the Chief Management Officer, the Deputy Secretary is responsible, with assistance from the Deputy Chief Management Officer, for developing a strategic management plan for business operations, and integrating efforts to transform business operations. And the military departments are also statutorily required to have chief management officers, business transformation offices, and

business transformation plans. At this point, DOD has taken some positive steps to institutionalize these positions and organizations, but in some cases, decision-making authority and relationships are not yet well defined.

But just creating positions and offices is not enough; success will depend on how effectively the department and the military departments can institutionalize these positions and organizations. This would include defining and clarifying the respective authorities, roles, and responsibilities. To do so will afford senior leaders, and those responsible for implementation such as you, the authority and means to become advocates for transformational change.

Getting leaders and organizations in place and developing sound plans is a good start. But to achieve real reform, the Department needs to set priorities, strengthen management accountability, execute its plans, gauge actual progress against goals, and make adjustments as needed. As part of GAO's broad body of defense related work, we have routinely seen that there is a lack of focus on developing and using interim performance measures to measure progress and the impact of actions taken. Everyone here has most likely seen many DOD improvement initiatives, often great in concept, fail or fall to the wayside due to a lack of sustained focus. Transformation initiatives need to be set forth into measurable steps toward a long-term goal, and then interim measures used to gauge progress and adjust strategy if needed. This approach is key to solving many of these long-standing problems.

Now let me turn to a few key examples of where DOD can tap its potential to improve business operations, save money, and optimize support to the warfighter.

Weapon systems acquisition management

Probably one of the best examples of where DOD could make real progress in the near-term is in improving its approach to acquiring major weapon systems. Since 2003, DOD's portfolio of major defense acquisition programs has grown from 77 to 96 programs; and its investment in those programs has grown from \$1.2 trillion to \$1.6 trillion (fiscal year 2009 dollars).¹ The chart below depicts the change in the size and performance of DOD's portfolios of major acquisition programs.

¹GAO, *Defense Acquisitions: Assessments of Selected Weapon Programs*, GAO-09-326SP (Washington, D.C.: Mar. 30, 2009).

Analysis of DOD Major Defense Acquisition Program Portfolios

Fiscal year 2009 dollars

	Fiscal year		
	2003	2007	2008
Portfolio size			
Number of programs	77	95	96
Total planned commitments	\$1.2 trillion	\$1.6 trillion	\$1.6 trillion
Commitments outstanding	\$724.2 billion	\$875.2 billion	\$786.3 billion
Portfolio indicators			
Change to total RDT&E costs from first estimate	37 percent	40 percent	42 percent
Change to total acquisition cost from first estimate	19 percent	26 percent	25 percent
Total acquisition cost growth	\$183 billion	\$301.3 billion ^a	\$296.4 billion
Share of programs with 25 percent increase in program acquisition unit cost growth	41 percent	44 percent	42 percent
Average schedule delay in delivering initial capabilities	18 months	21 months	22 months

Source: GAO analysis of DOD data.

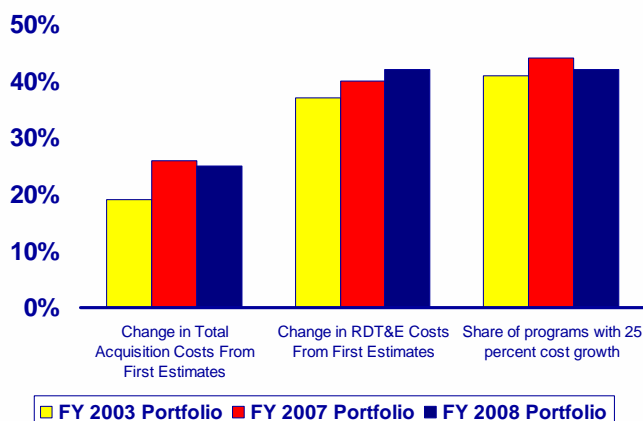
^aThe total acquisition cost growth for the 2007 portfolio was \$295 billion in 2008 constant dollars.

7

And, as the graph below shows, over 40 percent of all the major programs in DOD's fiscal year 2008 portfolio are about 25 percent over budget compared to initial estimates.

DOD Cost Outcomes

Percent of GDP

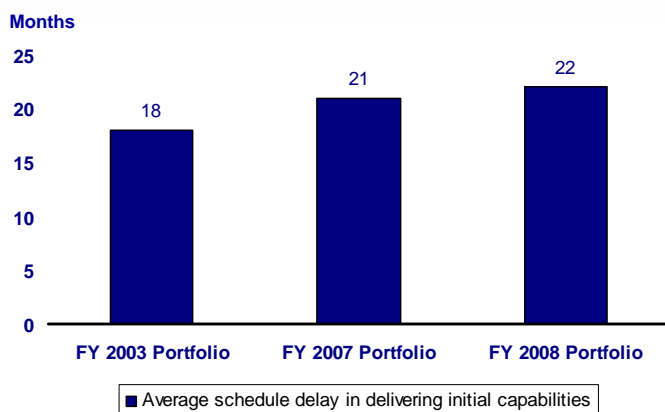


Source: GAO analysis of DOD data.

8

To add to the challenges, the average delay in delivering initial capabilities in DOD's portfolio of weapon systems programs has increased over time to 22 months, as shown in the graph below. DOD's performance in some of these areas is driven by older programs, as newer programs, on average, have not shown the same degree of cost and schedule growth.

DOD Program Schedule Outcome



Source: GAO analysis of DOD data.

9

Over the next 5 years, DOD expects to invest more than \$357 billion on major defense acquisition programs. To put the size of this figure in context, that is close to half of what Congress has provided to support overseas contingency operations over the past 8 years. Much of this investment will be used to address cost overruns due to shortcomings in planning, execution, and oversight. These types of problems have plagued DOD's weapon systems portfolio for the past 30 years. We see these problems as being at odds with the very capable and dedicated people we deal with frequently in the program offices and other key organizations. So, why aren't good people getting better outcomes? We have come to see recurrent problems as not due primarily to mistakes, lack of expertise, or unforeseeable events. Rather we see them as an outgrowth of a system in which key processes and incentives are better at saying "yes" than "no" to programs that do not measure up. The challenge is to change the dynamics of this culture.

Because of the magnitude of the investment and the current fiscal environment, DOD can no longer afford to let cost growth go unchecked and programs inch towards completion. On a positive note, Secretary Gates has identified the need for weapon systems acquisition reform as chief among DOD's institutional challenges. DOD is off to a good start. Last December, DOD made major revisions to its acquisition policies, which address many of the problems that can be traced back to the acquisition system. The revisions, which are in line with our past

recommendations, aim to provide key department leaders with the knowledge needed to make informed decisions before a program starts and to maintain discipline once it begins. To improve outcomes on the whole, though, DOD must ensure that these policy changes are immediately and consistently put into practice and reflected in decisions made on individual acquisitions. It must also clearly assign accountability to an individual or individuals for its implementation.

Additionally, Secretary Gates has identified programs that should either be adjusted or terminated, based in large part on their performance, cost-effectiveness, and ultimate value to the war fighter, which is an encouraging sign of change. However, process reforms, funding cuts, and cancellations are not enough to change the culture. Mission-essential programs with executable strategies, regarding the technology, design, test, and overall cost, must win the budget battles. Tough choices will need to be made about specific weapon systems, and stakeholders—from the military services to industry to the Congress—will have to play a constructive role in this process.

On a positive note, we have seen progress on new programs. For example, since 2006, programs entering system development have done so with higher levels of technology maturity—a key indicator of program success. Additionally, we found in our last comprehensive review of 47 DOD’s major acquisition programs that there were a few modest indications of improvement within the portfolio from 2007 to 2008, such as the fact that the total percentage of programs with 25 percent or more increases in program unit costs decreased by a few percentage points.

DOD still has work to do in this area, and there are ample opportunities for reform and improvement that can yield tangible results in the near-term and free up resources. From that standpoint, DOD needs to continue to review existing and planned programs to

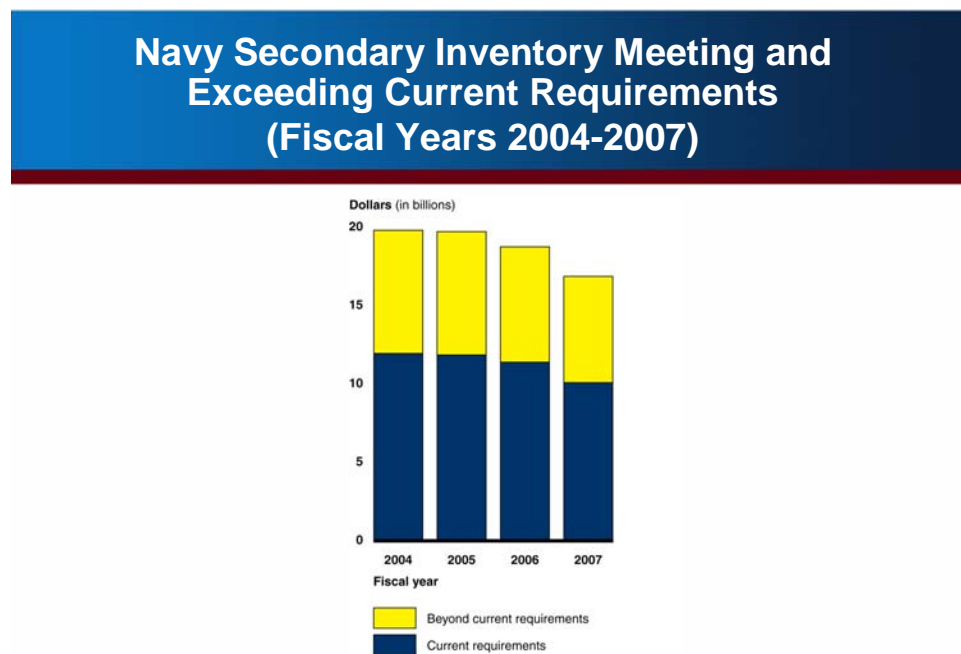
- determine the right mix of programs to invest in by making better decisions as to which programs should be pursued or not pursued given evolving mission needs and both existing and expected funding,
- ensure that programs are executable by matching requirements with resources and locking in those requirements, and
- make it clear that programs will then be executed based on actual knowledge and mature technology, and not assumptions that are often overly optimistic, and that program managers and senior leaders will be held responsible for that execution.

Inventory management

Improving DOD’s approach to inventory management is an opportunity for reform that could yield significant savings now and free up resources for other priorities. For example, DOD officials have estimated that the level of investment in the department’s supply chains is more than \$150 billion a year, and the value of its spare part inventories has grown by tens of billions of dollars in recent years. Yet, the department continues to have substantial amounts of

secondary inventory that are in excess to requirements. For example, in our last review of the Air Force's inventory, we reported that more than half of its secondary inventory, valued at about \$31 billion, was not needed to support required inventory levels from 2002 through 2005.

More recently, in our review of the Navy's secondary inventory, we found that, on average for fiscal years 2004 through 2007, about \$11 billion, or around 60 percent, of the total annual inventory value of \$18.7 billion was needed to meet current requirements, but \$7.5 billion, or about 40 percent, exceeded current requirements. The graph below shows, by fiscal year, the dollar amount of inventory that met and exceeded current requirements.



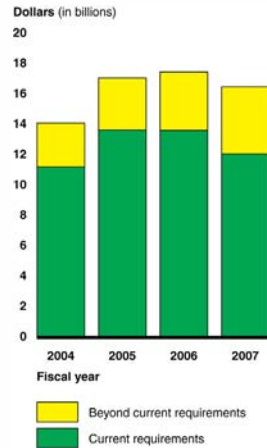
Source: GAO analysis of Navy data.

10

The Army is also retaining too much inventory that is not needed to meet requirements. Our review of the Army's secondary inventory showed that, on average, about \$12.7 billion, or about 78 percent, of the total annual inventory value of \$16.3 billion was needed to meet current requirements, whereas \$3.6 billion, or around 22 percent, exceeded current requirements.² Similar to the Navy, the graph below illustrates that the trend of retaining excess inventory has remained stable from fiscal years 2004 through 2007.

²Our analysis included secondary inventory from the U.S. Army Aviation and Missile Lifecycle and Management Command (AMCOM) and the U.S. Army TACOM Life Cycle Management Command (TACOM), but did not include the Army's Communication - Electronics Command (CECOM) because the information system used to manage secondary inventory was not able to provide item-specific data for the period of our review.

Army Secondary Inventory Meeting and Exceeding Current Requirements, (Fiscal Years 2004-2007)



Source: GAO analysis of Army data

Note: Values are expressed in constant fiscal year 2007 dollars. Analysis includes AMCOM- and TACOM-managed items.

11

A major cause for the accumulation in excess inventories is weaknesses in the military services' approach to forecasting demand as well as a lack of metrics and targets focusing on the cost efficiency of inventory management. More effective processes that identify and manage acquisition lead times are of critical importance to maintaining cost-effective inventories, budgeting, and having materiel available when it is needed. Overestimates and underestimates of acquisition lead time contribute to inefficient use of funds and potential shortages or excesses of spare parts.

The Department can strengthen the accountability and management of its secondary inventory. For example, we have recommended that the services evaluate why they experience decreases in demand for supplies, which contribute to having excess inventories; determine what actions are needed to better forecast demand; and take steps to implement these actions. Furthermore, we have made recommendations to develop performance goals and metrics to assess and track the cost efficiency of the services' inventory management practices and to provide for a greater oversight role to the service chief management officers for improving inventory management. We have also recommended changes in inventory management policies and practices that contribute to excess inventories. Lastly, DOD needs to implement effective processes to identify/manage acquisition lead times in order to maintain cost-effective inventories, budget wisely, and have materiel available when needed. Taking steps such as these to transform the way in which DOD manages its supply chain and inventory supplies will result in better mission-essential support to the warfighter and will free up resources wasted or tied up in unneeded spare parts for higher priority needs.

DOD has generally concurred with our recommended actions and has taken some steps to improve inventory management. For example, the Air Force has made some needed policy changes, and the Army has directed that more up-to-date operational information be provided to inventory managers so they can make more informed purchase decisions. Furthermore, we understand that the Office of the Secretary of Defense has initiated a study to develop options for improving demand forecasting of spare parts.

Recently, the Congress has also shown increased interest in reforming DOD's inventory management practices. For example, the House, as part of its report accompanying the fiscal year 2010 National Defense Authorization Act, suggests actions that DOD can take to improve the ways in which it forecasts demands for spare parts. Similarly, the conference report accompanying the Act would require DOD to submit a comprehensive plan for improving its overall inventory management practices, from improving demand forecasting to reducing current excess inventory stocks.

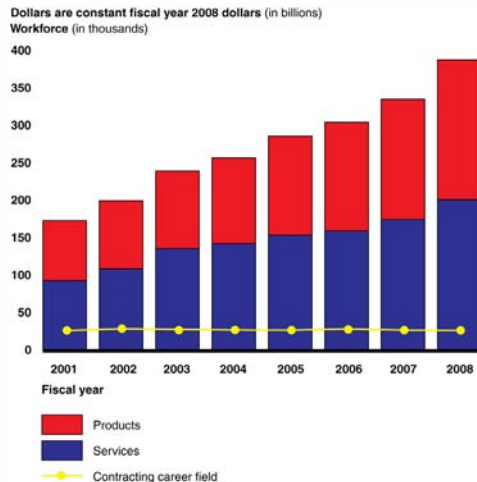
Contract management

DOD's management of contracts for goods and services, and the use of contractors in general, is another area that needs greater scrutiny and offers potential for saving money. Unfortunately, DOD's contracts have not always led to the desired outcomes and it is not always clear that DOD has been using sound business practices to acquire goods and services. On a positive note, the Secretary of Defense and other senior leaders have acknowledged these weaknesses and the need for reform, which has begun to prompt action within the Department.

Taking deliberate action now is critical because DOD has become reliant on contractors to meet critical missions, including those related to ongoing operations, and to support acquisition functions. For example, DOD reported that, as of the second quarter of 2009, over 200,000 contractor personnel were working in Iraq and Afghanistan.³ To put the level of contracting activity into perspective, between fiscal years 2001 and 2008, DOD obligations on contracts when measured in real terms have more than doubled to over \$387 billion in total, and to more than \$200 billion just for services. At the same time, DOD's acquisition workforce, responsible for contract management, has not similarly grown. In fact, during that same time period, DOD's contracting career field grew by only about 1 percent. The graph below clearly illustrates the problem—that the size of the contracting workforce has not kept pace with level of contracting activity.

³GAO, *Contingency Contracting: DOD, State, and USAID Continue to Face Challenges in Tracking Contractor Personnel and Contracts in Iraq and Afghanistan*, GAO-10-1 (Washington, D.C.: Oct. 1, 2009).

Changes in DOD's Contract Obligations and Contracting Workforce, Fiscal Years 2001 through 2008



Source: GAO analysis, Federal Procurement Data System-Next Generation, DOD.

12

To its credit, DOD has issued guidance to address contracting weaknesses and encourage the use of sound business arrangements. For example, consistent with congressional direction and GAO's recommendations, DOD established a process for reviewing major services acquisitions; issued regulations to better manage its use of contracting arrangements that can pose additional risks for the government, including time-and-materials contracts and undefinitized contracting actions; and has efforts under way to identify and improve the skills and capabilities of its workforce. For example, in November 2008 we reported that DOD has been developing, revising, and finalizing new joint policies and guidance on the department's use of contractors to support deployed forces and has begun developing training programs for personnel that do not work in the acquisition field to provide information necessary to operate effectively on contingency contracting matters and work with contractors on the battlefield.⁴

However, there is still much work to be done. We have recommended that DOD needs to (1) assess the risks that its increasing reliance on contractors poses, (2) determine the appropriate mix of contractor, civilian, and military personnel in shaping its total force for the future, including the role and use of contractors to support deployed forces, and (3) ensure that it maintains an acquisition workforce that is adequately sized, trained, and equipped, so that it can effectively plan, negotiate, award, and manage the range of contracts needed to meet the department's needs.⁵ In addition, because DOD has paid billions in award and incentive fees to contractors regardless of acquisition outcomes, we have also recommended ways that DOD can

⁴GAO, *Contract Management: DOD Developed Draft Guidance for Operational Contract Support but Has Not Met All Legislative Requirements*, [GAO-09-114R](#) (Washington, D.C.: Nov. 20, 2008).

⁵GAO, *Defense Acquisitions: Fundamental Changes Are Needed to Improve Weapon Program Outcomes*, [GAO-08-1159T](#) (Washington, D.C.: Sept. 25, 2008) and *GAO, A Knowledge-Based Funding Approach Could Improve Major Weapon System Program Outcomes*, [GAO-08-619](#) (Washington, D.C.: July 2, 2008).

continue to strengthen the link between contractor monetary incentives, such as award and incentive fees, and acquisition outcomes, which has started to show positive returns. Lastly, DOD should continue to focus attention on higher risk contracting strategies, such as the use of time-and-materials contracts and undefinitized contract actions, to ensure effective management of these approaches. Such efforts would also be consistent with recent direction from the Administration to reduce the use of high risk contracting strategies.

These critical contracting reforms, if successfully implemented, will improve the credibility of DOD's contracting processes. This will not only help ensure that that desired outcomes are achieved, but will also enhance the return on the significant investments of taxpayer dollars for the contracting of goods and services.

Financial management

Last but certainly not least, DOD must have reliable financial information. While DOD represents a big share of the federal budget, it is one of the few federal entities that cannot accurately account for its spending or assets. It is one of only 3 entities in the entire government that cannot pass the test of an independent audit. Without accurate financial information, DOD is severely hampered in its ability to make sound budgetary and programmatic decisions, monitor trends, make adjustments to improve performance, or maximize the use of resources.

Since the first financial statement audit was attempted at DOD nearly 20 years ago, GAO has consistently called for actions to address weaknesses in DOD financial management.⁶ DOD has launched several reform efforts over the years, but these have met with little success. Continued financial management and related deficiencies hinder DOD's ability to control costs, ensure basic accountability, anticipate future costs and claims on the budget, measure performance, and maintain control over funds. Problems with asset accountability further complicate critical functions, such as supporting the current plans to withdraw troops and equipment from Iraq.

DOD's new comptroller hopes to increase the program's chances for success by improving budgetary information and asset accountability. As shown below, the emphasis will be on two areas. First, strengthening information and processes supporting the Department's Statements of Budgetary Resources. Second, verifying the existence and completeness of mission critical assets, from weapons systems to real property to general equipment.

⁶GAO, *Defense Business Transformation: A Full-time Chief Management Officer with a Term Appointment Is Needed at DOD to Maintain Continuity of Effort and Achieve Sustainable Success*, GAO-08-132T (Washington, D.C.: Oct, 16, 2007).

Current Focus of DOD's Financial Management Efforts

- **Improve budgetary information and asset availability**
 - Strengthen information and processes, and achieve an auditable Statement of Budgetary Resources
 - Verify the existence and completeness of mission critical assets
 - Components must ensure records accurately capture the number of each type of weapon system, real property, inventory, and operating materials and supplies

13

Budgetary and asset-accountability information is widely used by DOD managers at all levels, so its reliability is vital to daily operations and management. The Marine Corps has just begun an audit of its fiscal year 2010 Statement of Budgetary Resources, and DOD is treating this as a test case. If the Marine Corps audit is successful, it will be used as a model for the other services.

We and the comptroller agree that DOD's current financial management priorities are necessary and critical to improving accountability and information for operations. When it comes to assets, DOD certainly needs to provide accountability over the existence and completeness of those items. GAO believes it may be worthwhile to revisit the question of how DOD reports assets in its financial statements because the traditional financial reporting model was not designed to address the unique aspects of military assets.

DOD components are developing detailed plans to support efforts to improve financial management in budgetary reporting and related operational processes and accountability for asset existence and completion. Based on what we have seen of the plan so far, we believe this prioritization is a reasonable approach for now. A consistent focus may increase the Department's ability to show incremental progress toward achieving auditability in the short term. In response to GAO's recommendations, the department has also put in place a process to improve standardization and comparability across components. The success of this process will depend on top management support, as well as high-quality planning and effective implementation at all levels.

Overall, we are encouraged by DOD's renewed attempt to improve its financial management and achieve accountability for its expenses and assets. GAO will continue to monitor progress and provide feedback on the status of those efforts. Among other things, we will seek to determine the reasonableness of efforts to achieve stated objectives and identify any gaps in strategic planning and coordination among the components. We will also track the progress of DOD's remediation plans for the remaining financial management areas. At some point down the road, I expect GAO and others will become involved in discussions about how DOD should be recording assets for financial statement purposes.

I should stress that financial management improvement efforts are also pivotal to achieving broader business transformation goals. Accurate, timely, and useful financial management information is essential for sound management analysis, decision making, and reporting.

Concluding Remarks

In closing, I want to reiterate that DOD has a real opportunity in the days ahead to set a new course for the future, take concrete steps to correct longstanding problems, and achieve meaningful results that can materially improve business performance. Given our nation's growing fiscal and other challenges, the Department cannot afford to delay addressing inefficiencies in its business operations and free up resources for higher priorities. The old ways of doing business, without regard to cost or outcome, are truly unsustainable.

In so many areas, DOD has the ability to achieve tangible and sustainable outcomes that will ultimately provide better support to the war fighter. Success will require strong leadership that sets the tone, takes decisive action, and assumes accountability for results. Success will also depend on sound plans that set clear priorities and measurable goals as well as results-oriented performance measures that can be used to gauge progress and make adjustments. Truly, DOD will need to approach the transformation of its business operations with the same level of intensity as it plans and carries out its military operations.

And while focused senior-leadership and clear planning are vital, success in transforming DOD's business operations is not possible without managers such as you who are willing to rethink the status quo, identify opportunities for reform, and actively push for change. Without you, transformation is just talk. There are countless ways that each of you, as members of a talented and experienced workforce, can make a real difference in how DOD does business.

The examples of reform that I have discussed today are really just the beginning. The reality is there are vast untapped opportunities to increase efficiency, improve effectiveness, reduce waste, and achieve perhaps the most important goal—to support the men and women who serve our country through the prudent and wise use of taxpayer dollars.

As I said at the outset, you face a difficult set of challenges, some of which are long-standing and some of which are new. When we consider these challenges together with the recent direction set by the President, the Congress, and the Secretary of Defense, it is clear that we are at a critical juncture, one that requires thoughtful but decisive action. Opportunities like this come around. The problems have been identified and fully debated. Now it is time to let the solutions dominate the discussion.

It has been a pleasure to be here today. We at GAO look forward to continuing to work with the Department on these important issues.